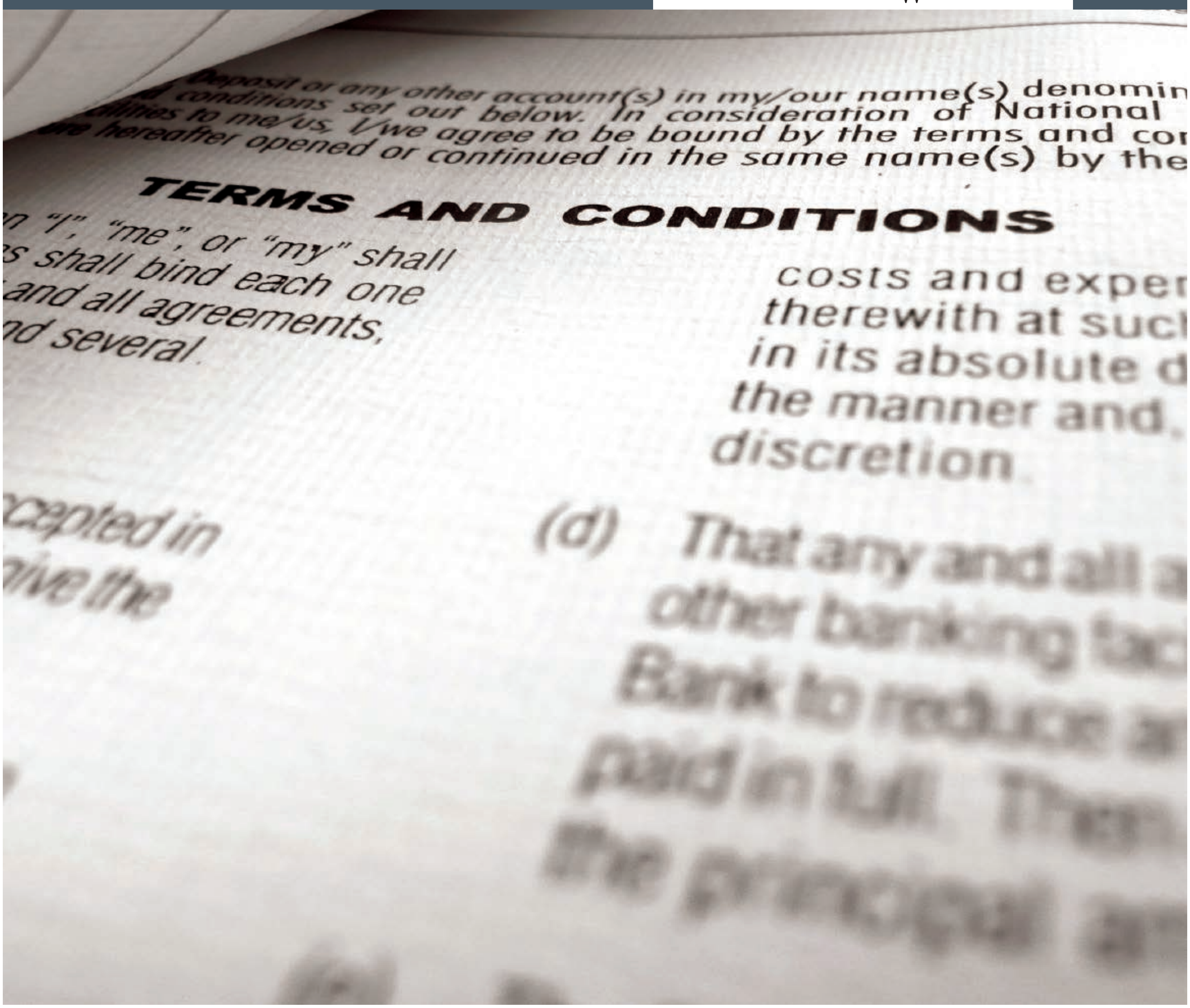
AFP ASSOCIATION FOR FINANCIAL PROFESSIONALS

AFP Guide

Negotiating and Complying with Credit Agreements

PREVIEW

In collaboration with HUNTON & WILLIAMS



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Introduction

For many U.S. companies, the pressure is on to review and renegotiate their credit facilities. Here's why:

- Interest rates have already began to inch upward.
- There's rising demand for credit because of an M&A surge and relatively cheap debt.
- Banks are readying themselves for the onset of Basel III capital and liquidity regulations.

As a result, many practitioners report that their banks are urging them to review and potentially reopen credit facilities, even if they're not due for some time, in order to lock in advantageous terms. Interviews with bankers, consultants, lawyers and many practitioners confirm this trend. While credit agreements are a perennial issue for treasurers, they are more top of mind now.

As companies look to renegotiate existing agreements or put in place new ones, they need to keep certain things in mind. What's particularly important is building a document that will allow a company flexibility to run its operations successfully for the duration of the facility. That means that compliance with the credit agreement needs to be a day-one issue and must be monitored on a continuous basis.

This guide, produced in collaboration with law firm Hunton & Williams LLP, traces the steps companies take in negotiating their credit facilities and how they prepare for and execute their compliance responsibilities. It offers practical advice and best practices and includes six case studies that illustrate how companies of different sizes, in different industries and of various credit standing are negotiating and complying with their credit agreements.

Factors Driving Interest in Renegotiation

Several external factors are making companies rethink their credit agreements:

- Basel III capital and liquidity rules.
- Other regulatory reform like the anti-money laundering act.
- Rising interest rates and globalization.
- Banks' reassessment of their business models and retrenchment from certain regions.

What's Driving the Interest in Renegotiation?

Many companies are encouraged to review their agreements now, because of the shifting regulatory environment. "Some Basel rules require banks to hold higher liquidity, especially when it comes to financial borrowers and CP backup facilities," said Michael Nardo, executive vice president of PNC Bank. "So far, there hasn't been as much pricing impact as I expected, but that remains to be seen," he said. "A lot of banks have been encouraging clients to refinance now before prices go up."

The other big change is the inclusion of a lot of language designed to comply with strict AML (anti-money laundering) regulations to ensure the money is being used for legal purposes." At the same time, according to Nardo, the market has seen a rise in demand. "The demand for bank loans is not so much affected by the rush in the corporate bond market as the boom in the M&A market."

According to Bill Booth, executive vice president of treasury management for National & Specialty Businesses at PNC Bank, with respect to the increasing regulatory environment, PNC pays more attention to the nature of the industry and its inherent risks. "My sense is that banks are now focusing more on underwriting not just the financial risk but also the operational risks, such as reputational challenges and third-party customer or supplier challenges that can end up impacting the client's financial performance," Booth said. "Bankers end up asking more questions, designed to make sure they have a much better understanding of the underlying business risks associated with that company, than they did pre-crisis."

The big U.S. banks are on the front end of this trend, according to Bob Novaria, partner at Treasury Alliance Group. "They have to force the issues," he said. What he sees in his practice is that banks are forced to scrutinize their own balance sheets and reassess their strategies. "No part of their business is untouched," he said. "It's not just about cash deposits, as some may think," Novaria said. "All areas will be touched, though not equally, which of course makes the conversations between corporates and their bankers a lot more customized and complex," he said. Novaria advised companies to be proactive in reaching out to their banks. "It's an unsettling time and a good time to do your homework, understand how banks view you, and how banks assign the risk rating to your company versus what you think your risk rating is," Novaria suggested. "Be assertive and ensure there's mutual understanding and agreement. Cultivate new relationships, figure out whether or not you're exposed to future changes, and make sure your relationships are sustainable over time."

According to Novaria, this new urgency is not just about interest rates and regulatory change. "You watch what the market has done in the last few months and you realize it's more and more global," he said. "This plays into the credit space. Banks are rewriting their approaches. Credit is the elephant in the room. It's going to be harder and more expensive to obtain."

That means many companies will have to right-size their facilities and target what they absolutely need as opposed to what they used to get, according to Novaria. "Banks are reexamining and rebalancing their portfolio of customers. Corporates may not be able to get their first choice or the least expensive cash management bank, because they may no longer have access to the credit they need," Novaria explained.

Another pressure point: some banks are unexpectedly exiting certain regions, so companies are left to fill the gap quickly. That trend has caused many companies to change their RFP process to require more transparency on the part of the banks, according to Novaria. "It may take longer than it used to take to replace a bank because of all the regulatory and credit concerns."

About the Author

Nilly Essaides is Director of the Financial Planning & Analysis (FP&A) Practice at the Association for Financial Professionals. Nilly has over 25 years of experience in research, writing and meeting facilitation in the global finance arena. She is a thought leader and the author of multiple in-depth AFP Guides on FP&A topics as well as monthly articles in AFP Exchange, the AFP's flagship publication. Nilly was managing director at the NeuGroup and co-led the company's successful peer group business. Nilly also co-authored a book about knowledge management and how to transfer best practices with the American Productivity and Quality Center (APQC).

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